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UNCLAS SECTION 01 OF 02 HARARE 002172

SIPDIS

SENSITIVE

STATE FOR AF/S
NSC FOR SENIOR AFRICA DIRECTOR JFRAZER
USDOC FOR 2037 DIEMOND
PASS USTR ROSA WHITAKER
TREASURY FOR ED BARBER AND C WILKINSON
USAID FOR MARJORIE COPSON

¶E. O. 12958: N/A
TAGS: ECON EFIN ETRD PGOV ZI
SUBJECT: Zimbabwe's Economy: Hardly a Pulse

Sensitive but unclassified. Protect accordingly.

¶1. (SBU) Summary: Robert Mugabe's government continues an assault on macroeconomics and private property. Without credible monetary and exchange policy, the country will only plunge more deeply into recession. End Summary.

5 Years of Ruinous Policy

¶2. (U) Consider these ominous indicators:

	1998	2002 (est)	change
Real GDP (US$ billions)	6.3	4.1	- 35%
Arrears (US$ millions)	95	1,635	+1700%
FDI (US$ millions)	444	3	- 99%
M3 (Z$ billions) (broad money supply)	57	495	+ 870%

The numbers, which fluctuate considerably due to methodology, tell the story of a breathtaking 5-year tumble, exacerbated by external shocks but brought about by economic mismanagement.

¶3. (U) In fact, the government has snubbed macroeconomic solutions at every turn. It has:

- expanded money supply aggressively to cover a widening revenue/expenditure gap.
- instituted price controls.
- cut interest on short-term bonds to one-fourth the inflation rate.
- raided private pension funds by compelling them to buy these money-losing securities.
- maintained an official exchange that is now just one-thirteenth the parallel rate.
- fired Finance Minister Simba Makoni, a rare official voice for spending cuts and devaluation.

¶4. (U) The results are unsurprising. Monetary expansion caused rampant inflation (currently at 135 percent by official estimates). Price controls triggered shortages, cosmetic repackaging and black-market profiteering. Low interest on bonds drove investors into equity and housing markets, which are in turn booming. Pension funds reluctantly underwrote government spending and debt servicing, depleting the country's overall savings (down from 25 to 7 percent of GDP since 1997) and impoverishing future retirees. And the preposterous official exchange has strangled much private sector activity - and sparked innumerable rent-seeking schemes.

An Opportunity Lost for Export-Driven Growth

¶5. (U) Tragically, the country has failed to make use of its weak currency, a formidable trade advantage, even vis-a-vis the depreciated South African rand. Falling exports have kept current accounts in deficit. Efforts to soften the currency burden on exporters - through lower lending rates and partial devaluations for export earnings - have made little difference. Over 80 percent of commercial activity already takes place at the parallel rate. Yet companies risk sanction for parallel market conversions and often halt production rather than submit to the official rate. The government has also increased licensing fees for exchange agents by 10-fold, adding another cost to the export sector.

Comment

¶6. (SBU) We see no prospect of recovery without a sweeping policy overhaul. Monetary growth, runaway spending, price controls and the official exchange rate all pound away at GDP. As it stands, the government is forecasting a further 5 percent retraction in 2003 while private economists expect 5-10 percent. The 10-percent

worst-case scenario would make for a cumulative 41 percent real GDP decline by the close of 2003.

¶7. (SBU) To climb out of this deepening pit, the country will need a stable business climate, tighter monetary control and plausible exchange regime. The government will have to broadly cut spending (deficit is now over 15 percent of GDP) and overcome its ideological disdain for private property. (At present, the government is not even willing to issue titles on the expropriated farmland it is doling out to supporters.) By selling off underperforming parastatals, it would raise needed forex to service external arrears. Such a change in policy would give the GoZ leverage to resume dialogue with the World Bank and International Monetary Fund, and seek better access for exports to the U.S. and Europe. While the above scenario - or some variation - may be Zimbabwe's eventual recovery scenario, its enactment is nowhere on the horizon.

Sullivan